

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

Year Ended December 31, 2012

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
Rural Water District No. 3
Osage County, Kansas

We have audited the accompanying financial statements of the Rural Water District No. 3, Osage County, Kansas, as of and for the year ended December 31, 2012, which comprise the District's basic financial statements as listed in the table of contents, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the guidance in the Kansas Municipal Audit and Accounting Guide (KMAAG) and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards and guidance require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

Auditor's Responsibility (Continued)

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

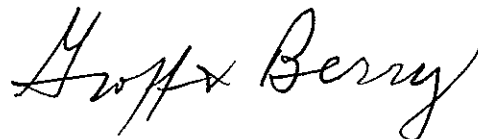
In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Rural Water District No. 3, Osage County, Kansas, as of December 31, 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other-Matters

In accordance with *Government Auditing Standards*, we have also issued our report dated January 30, 2013 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The District has not presented the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to supplement, although not to be part of, the basic financial statements.

January 30, 2013

A handwritten signature in black ink, appearing to read "L. Berry". The signature is written in a cursive, flowing style with a large initial "L" and a stylized "Berry".

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

STATEMENT OF NET POSITION
December 31, 2012

ASSETS

Assets:

Cash and cash equivalents	\$ 180,067
Accounts receivable	32,938
Interest receivable	1,187
Prepaid insurance	<u>7,288</u>

Total current assets 221,480

Restricted investments:

Revenue bond covenant accounts	59,000
Long-term certificates of deposit	213,673
Note receivable	<u>3,463</u>

276,136

Capital assets:

Property, plant and equipment	2,628,192
Less: accumulated depreciation	<u>1,259,489</u>

1,368,703

Other Assets:

Bond issue costs net of amortization	<u>33,406</u>
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Total assets \$ 1,899,725

The accompanying notes are an integral part
of these financial statements.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

STATEMENT OF NET POSITION
December 31, 2012

LIABILITIES AND NET POSITION

Liabilities:

Current maturities of long-term debt	\$ 80,000
Accounts payable	12,052
Accrued payroll	7,767
Accrued payroll taxes	671
Accrued interest	2,119
Other accrued expenses	<u>917</u>

103,526

Long-term liabilities:

Long-term debt, less current maturities	499,102
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Net Position:

Invested in capital assets, net of related debt	823,007
Restricted for debt service	59,000
Unrestricted	<u>415,090</u>

Total net position 1,297,097

Total liabilities and net position \$ 1,899,725

The accompanying notes are an integral part
of these financial statements.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

STATEMENT OF ACTIVITIES AND
CHANGES IN NET POSITION
Year Ended December 31, 2012

Operating revenues:

Water sales	\$ 222,156
Debt service charges	119,001
Late charges	13,206
Miscellaneous	<u>4,706</u>

Total operating revenues

\$ 359,069

Operating expenses:

Water treatment	20,231
Depreciation and amortization	62,919
Wages	86,349
Payroll taxes	6,949
Employee benefits	5,813
Repairs	38,817
Engineering	763
Annual water costs	14,434
Insurance	14,394
Utilities	18,565
Mileage	3,871
Office expense	956
Postage	2,851
Dues and subscriptions	412
Telephone	2,122
Training	1,842
Software	2,000
Legal	-
Accounting	4,395
Miscellaneous	2,412
Water protection fee	1,614
Bad debts	<u>739</u>

Total operating expenses

292,448

Operating income (forward)

\$ 66,621

Continued

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

STATEMENT OF ACTIVITIES AND
CHANGES IN NET POSITION
(Continued)
Year Ended December 31, 2012

Operating income (forward)		\$ 66,621
Non-operating revenue (expense):		
Interest income	5,326	
Interest expense	(23,373)	
Extensions and contributions	<u>5,832</u>	
Total nonoperating expense		<u>(12,215)</u>
Income before capital contributions		54,406
Capital contributions:		
Benefit units sold		<u>8,400</u>
Change in net position		62,806
Net position, beginning of year		<u>1,234,291</u>
Net position, end of year		<u>\$ 1,297,097</u>

The accompanying notes are an integral part
of these financial statements.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

STATEMENT OF CASH FLOWS
Year Ended December 31, 2012

Cash flows from operating activities:		
Receipts from customers		\$ 355,698
Payments to suppliers		(130,158)
Payments to employees for services		(93,298)
Other receipts		<u>4,706</u>
Net cash provided by operating activities		136,948
Cash flows from capital related		
financing activities:		
New debt issued	\$ 590,000	
Principal payments on long-term debt	(643,734)	
Interest paid	(29,009)	
Purchase of capital assets	(5,832)	
Benefit units sold	7,350	
Loan costs	(27,938)	
Contributions for construction	5,832	
Increase in reserve account	<u>(2,000)</u>	
Net cash used in capital and		
related financing activities		(105,331)
Cash flows from investing activities:		
Proceeds from certificates of deposit - long-term	43,388	
Principal payments on note receivable	114	
Interest income - CD's	<u>6,029</u>	
Net cash provided by investing activities		<u>49,531</u>
Net increase (decrease) in		
cash equivalents		81,148
Cash and cash equivalents, beginning of year		<u>98,919</u>
Cash and cash equivalents, end of year		<u>\$ 180,067</u>

Continued

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

STATEMENT OF CASH FLOWS
(Continued)
Year Ended December 31, 2012

Reconciliation of operating income to net cash
provided by operating activities:

Operating income	\$ 66,621
Adjustment to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	62,919

Changes in assets and liabilities:

Accounts receivable	(4,268)
Interest receivable	555
Prepaid expenses	(476)
Accounts payable	10,584
Accrued payroll	925
Accrued payroll taxes	148
Other accrued expenses	<u>(60)</u>

Net cash provided by operating activities	\$ <u>136,948</u>
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The accompanying notes are an integral part
of these financial statements.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS

1 - Summary of Significant Accounting Policies

Equity and Basis of Accounting

The District was organized under Kansas law and is accounted for as an enterprise fund using the accrual basis of accounting. The District is not included in any other governmental "reporting entity" as defined in GASB pronouncements, since Board members are elected by the patrons of the District, have decision-making authority, power to designate management, the ability to influence operations and primary accountability for fiscal matters. The District's purpose and objective is to acquire water and water rights, to build and acquire pipe lines and other facilities, and to operate the same for the purpose of furnishing water for domestic, agriculture and for other purposes. The District provides service to patrons in Osage County.

Statement of Cash Flows

For purposes of the statement of cash flows, the District considers all highly liquid investment instruments purchased with an original maturity of three months or less to be cash equivalents.

Investments

Investments represent nonnegotiable certificates of deposit. The certificates of deposit are recorded at cost because they are not affected by market rate changes.

Restricted Investments

Restricted investments represent amounts set aside for the repayment of the Water Utility System Revenue Bonds, Series 2012.

Accounts Receivable

Accounts receivable are carried at original invoice amount less any estimate made for doubtful receivables based on a review of all outstanding amounts. The District reads meters the first day of each month or the earliest day thereafter. Payments for water service are due by the 25th day of the month or will be subject to a 10% late charge. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts.

Management is of the opinion that no allowance for doubtful accounts is necessary.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Capital Assets

Capital assets, which include land, meters and distribution lines, buildings, and equipment, are shown at cost. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to expense as incurred; significant renewals and betterments are capitalized based on management's judgment. The District has a policy of capitalizing capital assets with a cost greater than \$ 5,000. A deduction is made for retirements resulting from renewals or betterments.

Other Assets

Costs associated with the issuance of bonds are being amortized using the straight-line method over the life of the bond issue.

Capital Contributions

The sales price of benefit unit certificates is considered a contribution to the District. Contributions by developers or patrons for extensions are recorded as patron contributions. Both of these capital contributions are shown on the statement of revenues, expenses and change in net assets.

Net Assets

The District's net assets are classified as follows:

Investment in capital assets, net of related debt - This represents the District's total investment in capital assets, net of accumulated depreciation and related debt.

Restricted for debt service - This represents resources set aside in a bond reserve account in accordance with the bond covenant.

Unrestricted - This includes resources derived from sales and services. These resources are used for transactions relating to providing sales and services and general operations of the District and may be used at the discretion of the governing board to meet current expenses for any purpose.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS
(Continued)

1 - Summary of Significant Accounting Policies (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes

Rural Water District No. 3, Osage County, Kansas is a tax-exempt entity and not subject to income taxes at either the federal or State level.

Budget

The District is not required to operate under the Kansas Budget laws. The District, however, prepares a budget worksheet yearly.

Annual Leave

Under terms of the District's personnel policy, District employees are granted annual leave in varying amounts. At year end, the District estimates that any unpaid vacation pay is immaterial to the financial statements taken as a whole.

2 - Deposits and Investments

At December 31, 2011 and throughout the year ended December 31, 2012, the District's investments included certificates of deposit. As of December 31, 2012, the District had the following investments and related maturities:

<u>Investment Type</u>	<u>Carrying Value</u>	<u>Investments Maturities (in Years)</u>			
		<u>Less Than 1</u>	<u>1 - 5</u>	<u>6 - 10</u>	<u>More Than 10</u>
Certificates of deposit	\$ <u>272,673</u>	\$ <u>-</u>	\$ <u>272,673</u>	\$ <u>-</u>	\$ <u>-</u>

Credit Risk. Kansas statutes authorize the District, with certain restrictions, to deposit or invest in temporary notes, no-fund warrants, open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury Bills and Notes, the State of Kansas Municipal Investment Pool or to make direct investments. Statues also require the collateral pledged to have a fair market value equal to 100 percent of the deposits and investments, less insured amounts, and to be assigned for the benefit of the District.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS
(Continued)

2 - Deposits and Investments (Continued)

Custodial Credit Risk - Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a formal policy that addresses custodial credit risk. At December 31, 2012, the District's deposits were not exposed to custodial credit risk.

At December 31, 2012, the carrying amount of the District's deposits, including certificates of deposit, was \$ 451,789 and the bank balance was \$ 451,409, of which \$ 428,736 was covered by federal deposit insurance and the balance was covered by a pledged security with an approximate market value of \$ 121,359 held by the counter party but not in the District's name.

Total deposits and investments of the District are shown in the financial statements as follows at December 31:

	<u>2012</u>
Cash and cash equivalents	\$ 179,116
Restricted investments:	
Revenue bond covenant accounts	59,000
Long-term investments	<u>213,673</u>
	<u>\$ 451,789</u>

3 - Note Receivable

In 1994, the District received a note from Lamont Hill Resort, Inc. To pay the District for providing water to its golf course. The original note balance was \$ 4,705. The term of the note is 35 years with principal and interest paid annually in the amount of \$ 372. The note bears interest at a rate of 7.21%.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS
(Continued)

4 - Capital Assets

Capital Assets - Property, Plant and Equipment, together with annual depreciation rates, consisted of the following:

	<u>Estimated Useful Lives</u>	<u>December 31, 2011</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31, 2012</u>
Capital assets					
Land		\$ 10,556	\$ -	\$ -	\$ 10,556
Meters and distribution lines	10 - 40 yrs	636,599	5,832	-	642,431
Buildings	15 - 50 yrs	1,904,872	-	-	1,904,872
Office Equipment	3 - 10 yrs	8,873	-	-	8,873
Plant Equipment	5 - 15 yrs	<u>61,460</u>	<u>-</u>	<u>-</u>	<u>61,460</u>
Total capital assets		<u>2,622,360</u>	<u>5,832</u>	<u>-</u>	<u>2,628,192</u>
Less: accumulated depreciation for:					
Meters and distribution lines		375,766	14,185	-	389,951
Buildings		788,917	38,523	-	827,440
Office equipment		8,593	70	-	8,663
Plant equipment		<u>28,832</u>	<u>4,603</u>	<u>-</u>	<u>33,435</u>
		<u>1,202,108</u>	<u>57,381</u>	<u>-</u>	<u>1,259,489</u>

5 - Long-Term Debt

Long-term debt consists of the following:

During September 2012, the District issued \$ 590,000 of Water Utility System Revenue Bonds, Series 2012, dated October 1, 2012 to refund the Kansas Rural Water Finance Authority Refunding Revenue Bonds, Series A, 2005 and the Kansas Department of Health and Environment (KDHE) loan. The bonds were dated October 1, 2012, the refunding was undertaken to take advantage of lower interest rates. Net revenue produced from the District's system was pledged as collateral against the bonds. The new bonds bear interest at rates ranging from 1.55% to 1.85%, including principal payments from \$ 80,000 to \$ 90,000 with \$ 5,000 due March 1, 2020, the maturity date.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS
(Continued)

5 - Long-Term Debt (Continued)

Annual debt service requirements to maturity for the bonds are as follows:

<u>Year Ending December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Due</u>
2013	\$ 80,000	\$ 6,844	\$ 86,844
2014	85,000	6,880	91,880
2015	80,000	6,143	86,143
2016	80,000	5,142	85,142
2017	85,000	4,083	89,083
2018 to 2020	<u>180,000</u>	<u>4,152</u>	<u>184,152</u>
	<u>\$ 590,000</u>	<u>\$ 33,244</u>	<u>\$ 623,244</u>

The following is a detailed listing of the District's long-term debt:

<u>Debt Issue</u>	<u>Date Issued</u>	<u>Original Amount</u>	<u>Interest Rates</u>
Revenue bonds, Series A, 2005	08-15-05	\$ 725,000	3.10 to 4.50%
KDHE loan	08-01-05	250,000	3.55%
Revenue bonds, Series 2012	10-01-12	590,000	1.55 to 1.85%

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS
(Continued)

The following is a summary of changes in long-term debt for the year ended December 31, 2012:

<u>Debt Issue</u>	<u>Beginning Principal Outstanding</u>	<u>Additions to Principal</u>	<u>Reductions of Principal</u>	<u>Ending Principal Outstanding</u>
Revenue bonds, Series A, 2005	\$ 465,000	\$ -	\$ 465,000	\$ -
KDHE loan	178,734	-	178,734	-
Revenue bonds, Series 2012	<u>-</u>	<u>590,000</u>	<u>-</u>	<u>590,000</u>
	<u>\$ 643,734</u>	<u>\$ 590,000</u>	<u>\$ 643,734</u>	<u>\$ 590,000</u>
Less: deferred charge on refunding				<u>10,898</u>
				579,102
Less: current maturities				<u>80,000</u>
				<u>\$ 499,102</u>

6 - Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; business interruptions; errors and omissions; employee injuries and illnesses; natural disaster; and employee accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. There have not been significant reductions in coverage from prior years.

7 - Adequacy of Rates Charged Customers for Services

The District is required to produce revenues sufficient to pay the cost of the operation and maintenance of the system; pay the principal of and interest on the Bonds when they become due and enable the District to have in each fiscal year net revenues, in an amount that will not be less than 125% of the debt service requirements. During 2012, this amount was met. At December 31, 2012, the District was serving 438 customers.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

NOTES TO FINANCIAL STATEMENTS
(Continued)

8 - Tax Covenants

The Chairman and Secretary have executed the Federal Tax Certificate in an approved form in order to ensure that the interest on the Series 2012 Bonds will remain excluded from federal gross income.

9 - Subsequent Events

Management has reviewed subsequent events through January 30, 2013.

SUPPLEMENTARY INFORMATION

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

Board of Directors
Rural Water District No. 3
Osage County, Kansas

We have audited the basic financial statements of Rural Water District No. 3, Osage County, Kansas, (the District) as of and for the year ended December 31, 2012, and have issued our report thereon dated January 30, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

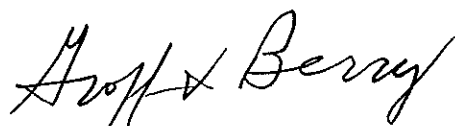
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and responses as Findings 2010-1, 2010-2 and 2010-3 that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

The District's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the District's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors, others within the entity and management and is not intended to be and should not be used by anyone other than these specified parties.



January 30, 2013

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

SCHEDULE OF FINDINGS AND RESPONSES

Year Ended December 31, 2012

Finding 2010-1 - Significant Deficiency (Repeated from Prior Year)

Condition - The District does not have an accounting system procedure manual at the present time. Currently, the bookkeeper is the only employee with access and appropriate knowledge about the accounting system.

Cause - Due to the small size of the District, there is a limited number of employees to perform financial duties.

Criteria - Assessing potential risks and having contingency plans is critical to the ongoing operations of the District.

Effect - This lack of a contingency plan could lead to service delays and an inability to produce financial information in the absence of the bookkeeper.

Recommendation - We recommend the development of a formal accounting system procedures manual to document the accounting processes of the District. This manual should outline accounting processes, report formats, account codes and descriptions, and similar descriptive material to be followed by the District.

Management's Response/Corrective Action Plan (Unaudited) - An accounting system manual is an ongoing project. Since none of the Board is an accountant and the bookkeeper has had no formal accounting education, this is a rather slow process. The Board does not feel this adversely affects the integrity of the District's accounting functions.

Finding 2010-2 - Significant Deficiency (Repeated from Prior Year)

Condition - The District does not maintain a detailed listing of capital assets that includes the asset description, cost, accumulated depreciation and current location of each asset. The District has relied upon the auditor to update and maintain the listing.

Cause - The District has not implemented procedures that would allow for the District to identify and maintain records for capital assets.

Criteria - Such a detailed listing is necessary to help insure adequate control over capital assets as well as to provide support for the financial statements.

Effect - The lack of maintaining a list of capital assets could lead to a misappropriation of the assets and misstatement of the capital assets.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

SCHEDULE OF FINDINGS AND RESPONSES
(Continued)

Recommendation - We recommend that the District implement procedures that would require at least an annual physical inventory of all capital assets and the creation and maintenance of a detailed capital asset listing.

Management's Response/Corrective Action Plan (Unaudited) - This has been taken under advisement and work will be started, utilizing a copy furnished by the auditor.

Finding 2010-3 - Significant Deficiency (Repeated from Prior Year)

Condition - The financial statements are the responsibility of the District's management. During the course of the audit, we made several adjusting journal entries, primarily to adjust balance sheet accounts.

Cause - An overall lack of understanding of generally accepted accounting principles.

Criteria - The financial statements are the responsibility of management. As such, The District's internal control over the financial statements should identify misstatements on a consistent basis. Also, management should have the ability to prepare and/or evaluate the District's financial statements.

Effect - Ineffective controls over the period-end financial statements resulted in the inability of management to prepare and/or evaluate the District's financial statements.

Recommendation - We recommend that management implement procedures to reconcile all accounts at year-end and to prepare and/or evaluate the District's financial statements.

Management's Response/Corrective Action Plan (Unaudited) - The Board of Directors makes every effort to insure that the District operates as efficiently as possible. Given the size and financial means of the District, The Board undertakes the oversight of some of the District's own accounting procedures so as to avoid the necessity of incurring further overhead by hiring additional staff. Due to the Board's involvement, several accounting and reconciliation processes have fallen to the responsibility of the Board. It is the Board's position that under the circumstances it is most cost efficient to operate in this manner and do not believe that it adversely impacts the integrity of the District's accounting functions to do so.

RURAL WATER DISTRICT NO. 3
Osage County, Kansas

INSURANCE COVERAGE
December 31, 2012

The District's insurance policy is provided by Continental Western Insurance Company, with a premium of \$ 15,557 and covers the period June 20, 2012 to June 20, 2013, it provides the following coverage:

Building and personal property (Deductible \$500, earthquake deductible of 10% applies)	\$	4,208,347
General liability		1,000,000
Products completed operations aggregate limit		1,000,000
Personal and advertising injury limit		500/500,000
Damage to premises rented		100,000
Medical expense limit		5,000
Employment practices each wrongful act (Deductible \$ 2,500 per claim)	1,000,000/1,000,000	
Public officials liability each wrongful act (Deductible \$ 1,000 per claim)	1,000,000/1,000,000	
Auto liability (non-owned vehicles)		500,000
Employee theft - per loss (Deductible \$ 500 per occurrence)		100,000
Commercial excess liability	1,000,000/1,000,000	
Worker's compensation		Statutory
Employer's liability		500,000